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IN THE
Supreme Court of the United States
OCTOBER TERM, 1979

—
No. 79-603

No. 79-742

—

UNITED STATES OF AMERICA, *Petitioner*

v.

HOTEL CONQUISTADOR, INC., ET AL.

—
On Petition and Conditional Cross-Petition for a
Writ of Certiorari to the United States Court of Claims

—
**BRIEF FOR HOTEL CONQUISTADOR, INC., ET AL.,
IN OPPOSITION TO PETITION AND IN SUPPORT
OF CONDITIONAL CROSS-PETITION**

—
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OPINIONS BELOW

The opinion of the Court of Claims (Pet. App. A. 1a-21a), as amended by the order modifying its opinion (Pet. App. B. 22a-23a), is reported at 597 F.2d 1348. The Government's motion for a rehearing *en banc* was denied by the seven active judges of the court. (Pet. App. B. 22a-23a.)

JURISDICTION

The judgment of the Court of Claims (Pet. App. C. 24a-25a) was entered on July 13, 1979. By order dated October 2, 1979, the Chief Justice, on application of the Government, extended the Government's time within which to file a petition for a writ of certiorari to and including November 10, 1979. The conditional cross-petition for a writ of certiorari was filed by Hotel Conquistador, Inc., et al., on October 11, 1979. The petition for a writ of certiorari was filed by the Government on November 8, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. 1255(1).

QUESTIONS PRESENTED

1. By the Petition:

Whether meals furnished without charge to employees for the convenience of their employer, and therefore admittedly not "wages" subject to withholding for Federal income tax purposes, are nonetheless "wages" subject to Social Security (FICA) and Federal Unemployment Insurance (FUTA) taxes.

2. By the Conditional Cross-Petition:

Where the Government asserts that an item constitutes wages for Federal Insurance Contribution Act (FICA) tax purposes, whether an employer, who sues for a refund of the *employer portion* of such tax paid with respect to such item, must first either reimburse his employees for the *employee portion* of FICA tax withheld from them with respect to such item or take some other steps to protect their interests in order to obtain refund of the employer portion.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 3101, 3102*, 3111*, 3121, 3301, 3306, 3401*, 3402*, 6402* and 6413* of the Internal Revenue Code of 1954 (26 U.S.C. (1971 ed.)) and of Treasury Regulations on Employment Tax, §§ 31.3121(a)-1, 31.3306(b)-1, 31.3401(a)-1*, 31.6402(a)-2*, and 31.6413(a)-1* (26 C.F.R.) are set forth in the Appendix, *infra*, 1a-8a. (The Sections of the Code and Regulations marked with an asterisk have not been included in the appendices to the Government's petition.)

STATEMENT

During the year in suit, 1971, Hotel Conquistador, Inc., operated the Tropicana Hotel, a resort hotel in Las Vegas, Nevada, and on the same premises its predecessor, Tropicana Casino, Inc., operated a casino. (Stip. pars. 1, 2; Stip. Ex. 6'.) In addition to the hotel and casino, the Tropicana operated several restaurants and an employees' cafeteria on its premises. (Stip. par. 3.) During the year 1971, an average of 1,193 meals per day were served in the Tropicana to employees at the Tropicana's expense in order to minimize the amount of time that the employees would need for meals during working hours. (Stip. pars. 3, 14, 18, 19). All employees who received such meals worked on the premises of the hotel, restaurant, and casino complex. (Stip. par. 3.)

None of the employees were required to remain on the employment premises during meal periods or to

¹ "Stip. par." refers to the numbered paragraphs of the Stipulation of Fact filed with the Court of Claims. For ease of reference, Hotel Conquistador and Tropicana Casino will be collectively referred to herein as the "Tropicana".

accept the meals provided in the employees' cafeteria or in the hotel coffee shop, but by reason of providing such meals on the employment premises, the employees' meal periods could be limited to 30 to 45 minutes. Due to the unavailability of adequate, nearby meal facilities, one hour to one hour and 15 minutes would have had to have been allowed the employees if meals were not served to them on their employment premises. (Stip. pars. 16, 17.)

Furthermore, most of the employees to whom the meals in question were furnished (e.g., maids, dealers, waiters and waitresses, and maintenance personnel) wore uniforms furnished without charge by the Tropicana. These employees were not permitted to use the public restaurants on their employment premises while in uniform and were not permitted to leave such premises while wearing their uniforms. (Stip. par. 18.) By serving the meals in question to the employees in the employee cafeteria on the premises, the Tropicana did not have to provide the additional time necessary for those employees to change clothes in order to leave the premises in order to obtain their meals. (Stip. par. 19.)

During 1971, three general classes of individuals were employed by the Tropicana:

1. Union employees whose labor agreements contained a provision requiring that meals and uniforms be provided without charge;
2. Union employees whose labor agreements did not contain a provision requiring that meals and uniforms be provided without charge; and
3. Non-union employees. (Stip. pars. 8, 13.)

The policy and practice of the Tropicana during 1971 —without regard to whether the employees were members of a union and without regard (in the case of union members) to whether the Tropicana was required to furnish such meals—was to provide all of its employees at least one meal per day without charge in the employees' cafeteria, except showgirls and dealers who were furnished meals at half charge in the main floor hotel coffee shop, and executives, department heads, pit bosses and accounting personnel who were furnished meals without charge in the coffee shop. (Stip. par. 7.)

For the year 1971, the Tropicana returned and paid to the Internal Revenue Service FICA and FUTA taxes on the employee meals based on a meal value of \$.45 per meal. (Stip. pars. 24-27.) After the payment of these taxes, the Internal Revenue Service asserted that the meals should be valued at \$1.25 per meal, and accordingly asserted that the Tropicana owed additional FICA and FUTA taxes with respect to such increased meal value. (Stip. par. 28.)

Thereafter, on March 7, 1973, the Tropicana timely filed with the Internal Revenue Service protests to this proposed adjustment, claiming that FICA and FUTA taxes did not apply at all to the meals served the employees, since they were furnished for the convenience of the employer, and that in any event, the value of the meals did not exceed \$.45. (Stip. par. 30, Stip. Exs. 12, 13.) The Internal Revenue Service ultimately refused to accept the Tropicana's position that the meals in question were not subject to FICA and FUTA taxes, and asserted additional taxes on the basis of \$1.25 per meal, which were subsequently assessed and paid. (Stip. pars. 36-40.)

Formal claims were thereafter filed by the Tropicana with the Internal Revenue Service in July, 1975, for refund of all the FICA and FUTA taxes paid by the Tropicana with respect to the employee meals. Attached to these claims was a listing of all employees whose wages were involved. (Stip. pars. 43-44, Stip. Exs. 14-17.) These claims for refund were formally disallowed by the Internal Revenue Service by letter dated October 1, 1975. (Stip. par. 45.)

At no time has the Internal Revenue Service asserted that the meals in question were subject to withholding of income tax as required on "wages" by Internal Revenue Code Section 3402 or otherwise constituted income to the employees for income tax purposes. (Stip. par. 41.) Moreover, the Internal Revenue Service has never asserted that the uniforms furnished without charge to the employees are either subject to income tax or withholding of income tax, or subject to FICA or FUTA tax imposed on "wages" by Internal Revenue Code Sections 3402, 3101, 3102, 3111 or 3301. (Stip. par. 42.)

The instant suit for refund was filed in the Court of Claims on October 23, 1975, and a motion for summary judgment was filed by the Tropicana on September 6, 1977. In response, the Government moved to suspend the proceedings due to the pendency before this Court of *Central Illinois Public Service Co. v. United States*, later decided at 435 U.S. 21 (1978), stating that this Court's forthcoming decision in *Central Illinois* would have a "direct impact on the instant case". (Government's Motion for Suspension of Proceedings, filed in the Court of Claims October 6, 1977, pp. 2-3.) The Government subsequently filed its own cross-motion for summary judgment on January 23, 1978, noting in its brief:

Because the term "wages" has the same meaning under all the employment taxes, [the decision of the Court of Appeals in *Central Illinois* involving income tax withholding] is squarely in point here.

(Government's Brief in Support, filed in the Court of Claims January 23, 1978, p. 22, fn. 8.)

After the decision of this Court in *Central Illinois*, and after receiving the written recommendation of the Chief Counsel of the Internal Revenue Service (who had previously solicited the written views of his Refund Litigation, Interpretative, and Legislative and Regulations Divisions) as to the impact of the *Central Illinois* decision, the Government authorized a full refund to the Tropicana of the amounts for which the instant suit has been brought. (Government's Motion for Enlargement of Time, filed in the Court of Claims April 3, 1978, and the Government's Motion for Suspension of Proceedings, filed in the Court of Claims April 21, 1978.)

Upon rejection of the tendered refund, the Government deposited the refund with the clerk of the Court of Claims and moved to dismiss the proceedings on the grounds of mootness. The Court of Claims denied the Government's motion to dismiss, holding that a party who has sued the United States in a tax case is entitled to a decision on the merits, and after hearing, held in its opinion entered April 18, 1979, that the employee meals furnished by the Tropicana were not "wages" for FICA and FUTA tax purposes. (Pet. App. A. 18a-19a.)

The Court of Claims also held that a portion of the FICA refund to which the Tropicana would be otherwise entitled should be denied because of a deficiency in the Tropicana's claim for refund. (Pet. App. A.

16a-17a.) The Court of Claims held that in order for an employer to claim refund of the employer portion of the FICA tax,² the employer must first either reimburse his employees for the employee portion of FICA tax withheld from them or take some other steps to protect their interests. (Pet. App. A. 16a-17a.) This issue had not been raised by the Government until it filed its reply brief on December 22, 1978, over three years after the instant suit was filed on the Court of Claims, and almost six years after the Tropicana formally asserted to the Internal Revenue Service that the employee meals were not subject to FICA and FUTA taxes. (Pet. App. A. 17a; Stip. par. 30.)

ARGUMENT

I. Reasons for Denying the Government's Petition.

A. There is no outstanding conflict.

The Government claims (Pet. 8) that the decision of the court below conflicts with *S.S. Kresge Co. v. United States*, 379 F.2d 309 (C.A. 6th, 1967) and *Pacific American Fisheries v. United States*, 138 F.2d 464 (C.A. 9th, 1943). This is not so for the reasons (1) that irrespective of what was stated in those cases as to the "convenience of employer" test being inapplicable to FICA and FUTA taxes, such statements are *dicta*, since in each case it was specifically found that *in fact* the meals in those cases were *not* furnished as a convenience to the employer, but as compensation for

² The FICA tax is paid equally by the employer and by the employee, the latter by means of the employer withholding from the "wages" paid by the employer to the employee. Sections 3101, 3102 and 3111 of the Internal Revenue Code, App. *infra*, 1a-2a.

specific work done³ (*Kresge*, 379 F.2d at 310; *Pacific American Fisheries*, 138 F.2d at 466)—making such cases clearly distinguishable on the facts from the instant case, and (2) that, as found by the court below, whatever precedential value such statements may have had, they are, in any event, no longer viable as precedents in the light of this Court's subsequent decision in *Central Illinois Public Service Company v. United States*, *supra*, which specifically rejected a broad and sweeping definition of "wages" for employment tax purposes.

The Internal Revenue Code imposes four different forms of "employment tax": (1) income tax withholding required of employers under Section 3402; (2) employee income tax under the Social Security Act (FICA) required to be withheld by employers under Sections 3101 and 3102; (3) employer excise tax under the Social Security Act (FICA) payable by employers under Section 3111; and (4) employer excise tax (FUTA), payable by employers under Section 3301.

³ In *Kresge* an employee could not obtain a free meal unless in consideration therefore he agreed to render specific additional service during the meal period not rendered by other employees. 218 F. Supp. 240, 243-244 (E.D. Mich., 1963). In *Pacific American Fisheries*, employees furnished meals were paid substantially less for the same services than employees not furnished such meals, and the value of the meals furnished was estimated to be approximately 50% of the value of cash wages they were paid. 138 F.2d at 465-466. By contrast it was conceded by the Government in the instant case that the meals were furnished for the convenience of the employer (Pet. App. A. 9a); no work or services were performed, nor could an employee voluntarily elect additional cash wages or other benefits in lieu of accepting such meals (Pet. App. A. 9a-11a) and the value of the meals was relatively nominal in relation to cash wages—8.3% using the Government's valuation of the meals and 3% using the Tropicana's valuation. (Stip. par. 22; also see Pet. App. A. 10a, 21a.)

All four employment taxes are imposed on "wages". "Wages" is defined by statute for income tax withholding purposes in Section 3401 as "all remuneration . . . for services performed by an employee for his employer," and in essentially identical terms for FICA and FUTA tax purposes in Sections 3121 and 3306 as "all remuneration for employment". (App. *infra*, 2a.)

Prior to and during the pendency of this case below, the Government repeatedly recognized the identity of the meaning of the term "wages" for all employment tax purposes. After specifically referring to the statutory definition of "wages" for FICA, FUTA and income tax withholding purposes, the Government told the Fourth Circuit on brief in *Royster Co. v. United States*, 497 F.2d 387 (C.A. 4th, 1973)—involving all four employment taxes—that:

In view of the similarity of these definitions, we agree with the District Court's conclusion . . . that the term "wages" has the same meaning for all of the employment taxes involved. (Gov't Brief, p. 6.)

The Fourth Circuit agreed, holding that meal reimbursements there involved were not subject to income tax withholding, FICA, or FUTA tax. 479 F.2d at 390.

Then, in the instant case, when it was seeking to rely on the decision of the Seventh Circuit in *Central Illinois*, 540 F.2d 300 (1976), later reversed by this Court, 435 U.S. 21 (1978), the Government advised the Court of Claims:

Because the term "wages" has the same meaning under all the employment taxes, [the decision of

the Court of Appeals in *Central Illinois* involving income tax withholding] is squarely in point here.⁴

Thus, the present contention of the Government (Pet. 16) that the *Central Illinois* decision of this Court "upon which the Court of Claims relied in denying the existence of a conflict . . . does not bear upon the question presented in this case" is totally incorrect.

In *Central Illinois* this Court rejected the Government's argument that lunch payments of \$1.40 per meal received by employees pursuant to a collective bargaining agreement negotiated by the employees' union were "wages" subject to income tax withholding required of employers under Sections 3401-3404. *Id.* at 29.⁵ The Government contended in *Central Illinois* that since the "payments at issue were a result of the employment relationship and were a part of the total of the personal benefits that arose out of that relationship", they necessarily constituted "wages". *Id.* This Court specifically rejected this "expansive and sweeping definition of wages" finding it to be inconsistent with the Congressional purpose of setting forth a standard "intentionally narrow and precise." 435 U.S. at 31. This Court emphasized that the tax base was limited to "wages", and that such term was limited by

⁴ Gov't Brief in Support of Cross-Motion for Summary Judgment, p. 22, fn. 8.

⁵ In reversing the Seventh Circuit this Court followed the earlier view of *Royster*, *supra*. Although reaching a different conclusion as to whether meal reimbursements were subject to tax, even the Seventh Circuit agreed that "wages" has the same meaning for FICA, FUTA and withholding tax purposes. 540 F.2d at 302, fn. 2.

the withholding statute to mean "all remuneration . . . for services performed by an employee for his employer", 435 U.S. at 29, essentially the identical language of the FICA and FUTA statutes.

There is no outstanding conflict between the decision of the court below and any other court, and in light of this Court's opinion in *Central Illinois*, it appears extremely unlikely that any conflict will develop hereafter.⁶

B. The question presented was correctly decided below.

Although income tax withholding was not adopted until 1942, meals furnished to employees for the convenience of their employer have been consistently regarded as non-compensatory in nature and therefore not income to employees for purposes of income tax. Thus, even though the Revenue Acts as early as 1918 specifically defined income as including "wages . . . of whatever kind and in whatever form paid" (Section 213, Revenue Act of 1918, 40 Stat. 1057), the regulations and rulings issued by the Bureau of Internal Revenue as early as 1918 directly recognized that such term did not include the value of "board" or "living quarters . . . furnished to employees for the convenience of the employer." Reg. 45, Art. 33 (1918); O.D. 265, 1 Cum. Bull. 71 (1919); O.D. 514, 2 Cum. Bull. 90 (1920). This principle was repeatedly reiterated by the

⁶ The issue involved is admittedly of substantial importance. Whatever administrative disruption or spawn of litigation may result (Pet. 8-10) is within the control of the Government. It is the Government's inconsistent and contradictory treatment of the matter that produced confusion, and the decision below correctly resolves the matter in light of *Central Illinois*. Review by this Court is not warranted.

Government in rulings and regulations in the 1920s, 1930s, and 1940s, and—as pointed out by this Court, two years ago in *Commissioner v. Kowalski*, 434 U.S. 77, 88, fn. 21—also received during this period the repeated approval of the courts. Finally, in 1954 the rule was codified in Section 119 of the Code, with the requirement, however, that in order to be excluded, such meals must be furnished on the business premises of the employer.

Despite such repeated construction of the term "wages" for income tax purposes over the past 60 years, the Government claims (Pet. 15-16) that "a series of published rulings . . . have consistently construed the FICA and FUTA regulations as requiring" taxability of meals such as are here involved. Such assertion is simply not true. Immediately after the enactment of the Social Security Act in 1935 (49 Stat. 636), the Treasury in 1936 promulgated Regulation 90, Article 207 (relating to the Federal unemployment insurance excise tax on employers imposed by Title IX of the Social Security Act) which provided:

Ordinarily, facilities or privileges (such as . . . cafeterias, restaurants . . .), furnished or offered by an employer to his employees generally, are not considered as remuneration for services if such facilities or privileges are offered or furnished by the employer merely as a convenience to the employer or as a means of promoting the health, good will, contentment, or efficiency of his employees.

In 1937, the then Bureau of Internal Revenue issued S.S.T. 110, 1937-I Cum. Bull. 440, holding "supper money" paid an employee who worked overtime for the convenience of the employer as not constituting "wages" for purposes of what are now referred to as

FICA and FUTA taxes.⁷ S.S.T. 192, 1937-2 Cum. Bull. 449, was later issued in 1937 and provided that lunches served employees could constitute "wages" for FICA and FUTA purposes. However, this ruling was revoked the next year by S.S.T. 302, 1938-1 Cum. Bull. 456, which held that, if furnished for the convenience of the employer, such meals would not constitute "wages" for FICA and FUTA tax purposes,⁸ citing as authority Reg. 90, Art. 207, *supra*, Reg. 91, Art. 14, *supra*, and S.S.T. 110, *supra*.

It is true that in 1940 Regulations 106 and 107 were issued which purported to eliminate the exclusion from "wages" for FICA and FUTA tax purposes of meals served for the convenience of the employer. Regulation 106, Section 402.227, and Regulation 107, Section 403.227, contained identical language on this point, which, after providing that "facilities or privileges" furnished employees do not ordinarily constitute remuneration for employment, stated:

... The term "facilities or privileges," however, does not ordinarily include the value of meals or

⁷ Significantly, the Bureau cited as authority for its decision in S.S.T. 110 its previous income tax ruling, O.D. 514, 2 Cum. Bull. 90, issued in 1920, which held that "supper money" furnished under such conditions did not represent taxable income to an employee for income tax purposes.

⁸ The holding in S.S.T. 302 that FICA and FUTA taxes would not apply referred to the following facts:

... The M Company has now established that the free lunch privileges are afforded solely to promote its own interests; that the wage scale of its employees has not been lowered to reflect the value of such items; that the lunches are not furnished as additional compensation for services; that such lunches are voluntarily offered to the employees; and that the lunches are furnished for the convenience of the M Company, and benefit the company by promoting the health, good will, and efficiency of its employees.

lodging furnished, for example, to restaurant or hotel employees, . . . since generally these items constitute an appreciable part of the total remuneration of such employees.

Then, in 1943, the Current Tax Payment Act (57 Stat. 126) added Sections 1621-1632 to the Internal Revenue Code of 1939 which required employers to withhold income tax due on "wages" paid to their employees. The Service almost immediately issued Regulation 115, Section 404.101, providing that:

... If . . . living quarters or meals are furnished to an employee for the convenience of the employer, the value thereof need not be included as wages subject to withholding.

This was long before the "convenience of the employer" rule was codified in Section 119. This contemporaneous interpretation of this particular employment tax statute is highly significant in light of the Senate Report issued in connection with the adoption of the underlying statute, in which the Congress expressed a clear intent to adopt as a definitional base for withholding of income tax the identical base previously adopted for Social Security taxes. After noting that income tax withholding (like the FICA and FUTA tax) was to be imposed on "wages", the report stated that:

With certain specified exceptions, the term is defined to include all remuneration whether designated as salary, wages, fees, commissions, etc., and whether paid in cash or property, if paid for services performed by an employee for his employer . . . [t]hese exceptions are identical with the exceptions extended to such services for Social Security tax purposes and are intended to receive the same construction and have the same scope. (Em-

phasis added.) S. Rep. 1631, 77th Cong., 2d Sess. 166 (1942)⁹

Despite such clear Congressional understanding that the term "wages" was to be construed alike for purposes of all employment taxes, Mim. 5657, 1944 Cum. Bull. 550, was issued in 1944 specifically holding that although meals served employees for the convenience of their employers were not "wages" for withholding tax purposes, such meals were "wages" for FICA and FUTA tax purposes. However, S.S.T. 302, *supra*, issued in 1938, was left standing, which held that meals served employees for the convenience of their employer would *not* constitute wages for FICA and FUTA tax purposes.

The treatment of employee meals was even further confused by the issuance in 1957 of Revenue Ruling 57-471, 1957-2 Cum. Bull. 630, which, in an unsuccessful attempt to reconcile S.S.T. 302, *supra*, and the applicable regulations, held that although meals served employees of a *bank or trust company* for the convenience of the employer would not constitute "wages" for FICA and FUTA purposes (see S.S.T. 302,

⁹ The understanding of the Congress that the base is the same for all employment taxes was reiterated as recently as last year when Section 119 was amended so as to make clear that the exclusion applies to "meals furnished an employee for the convenience of the employer, although the employer imposes a partial charge for the meal". Section 4, H.R. 12841, 95th Cong. 2d Sess., enacted into law as P.L. 95-427. In answer to a specific inquiry on the floor of the Senate as to the effect of the bill on "income tax withholding, social security (or FICA) tax, and unemployment (or FUTA) tax", Senator Long, Manager of the bill containing the amendment, responded that it was intended that "an item excluded from gross income will also be excluded from the definition of 'wages' for all payroll tax purposes". (Cong. Rec. S12367 (daily ed. Aug. 2, 1978)).

supra), meals served employees of *food preparation establishments* (such as hotels, restaurants or cafeterias) for the convenience of their employers would constitute "wages" for FICA and FUTA tax purposes. Five years later, the Internal Revenue Service issued Revenue Ruling 62-150, 1962-1 Cum. Bull. 213, which revoked S.S.T. 302, *supra*, stating, without explanation, the principle on which it now relies that, although the convenience of the employer test was applicable for income tax purposes, it was "no longer" a test for FICA and FUTA tax purposes. All of these changes in position by the Treasury occurred during a period in which there was no change by the Congress in the applicable statutes.

The court below found the meals in issue "were not 'remuneration' and, therefore, not 'wages.'" (Pet. App. A. 5a.) This decision, we submit, is compelled by the language of the statute, the legislative history, and the analysis of the term "wages" by this Court in *Central Illinois*.

C. There is no basis for the Government's claim that the regulations and rulings "unambiguously require the inclusion of meals in the FICA and FUTA 'wages' tax base", and that such requirement must be adhered to by the courts.

The Government asserts (Pet. 13) that the FICA and FUTA Regulations "were promulgated pursuant to specific congressional delegations of authority" and implies that such regulations are "legislative" in nature (rather than merely interpretative) and should be given some special weight by the courts. But, as the petition itself points out, the Government's authority to issue regulations is derived from Sections 808 and 908 of the Social Security Act which have now been

incorporated into Section 7805 of the 1954 Code "without any change in meaning or scope". (Pet. 13, fn. 13.) Section 7805 provides authorization for the issuance of "all needful rules and regulations for the enforcement of this Title" (i.e., Title 26, the entire Internal Revenue Code). The authority thus given to the Treasury Department by the Congress to issue regulations with respect to the Social Security taxes is no different, and no broader, than the interpretative regulation authority of the Treasury Department with respect to the Internal Revenue laws in general.

In *Social Security Board v. Nierotko*, 327 U.S. 358 (1946), this Court had before it a similar assertion that the Government had the ability to determine by regulation what was or was not "wages" for Social Security tax purposes. In refusing to accept the Government's attempt to define the word "wages" as having a meaning different from that ordinarily understood by such term, this Court observed that under the Social Security Act, the validity of regulations issued under the Act was specifically reserved for judicial determination. *Id.* at 368. Of specific relevance to the instant case is the following statement by the Court:

. . . Administrative determinations must have a basis in law and must be within the granted authority. Administration when it interprets a statute so as to make it apply to particular circumstances acts as a delegate to the legislative power. . . . Congress might have delegated to the Social Security Board to determine what compensation paid by employers to employees should be treated as wages. Except as such interpretative power may be included in the agencies' administrative functions, Congress did neither. An agency may not finally decide the limits of its statutory power. That is a judicial function. Congress used a well

understood word—"wages"—to indicate the receipts which were given to govern taxes and benefits under the Social Security Act. 327 U.S. at 369.

As stated previously, the Government has changed its published positions on the treatment as FICA and FUTA "wages" of meals served for the convenience of the employer no less than *five* times, notwithstanding the absence of any change whatsoever in the applicable statutes.¹⁰ The rulings are inconsistent and for that reason alone fail the test of "plausibility and consistency" admitted by the Government to be a prerequisite for judicial acceptance. (Pet. 16.) Off and on, for approximately 26 years, from the issuance in 1938 of S.S.T. 302, *supra*, until its revocation without explanation in Rev. Rul. 62-150, *supra*, the Government specifically recognized the convenience of the employer test as being applicable to a determination of FICA and FUTA wages. Against this background, the refusal of the court below to defer to the Government's present published position is appropriate.

Moreover, as noted by this Court in *National Muffler Dealers Association v. United States*, No. 77-1172 (March 20, 1979), judicial acceptance of a regulation or the commissioner's interpretation of it is dependent upon a showing that it " 'implement[s] the congressional mandate in some reasonable manner' . . . ". This

¹⁰ Compare S.S.T. 110, 1937-1 Cum. Bull. 440 (meals not treated as wages); S.S.T. 192, 1937-2 Cum. Bull. 449 (meals treated as wages); S.S.T. 302, 1938-1 Cum. Bull. 456 (meals not treated as wages); Mim. 5657, 1944 Cum. Bull. 550 (meals treated as wages); Rev. Rul. 57-471, 1957-2 Cum. Bull. 630 (meals served bank employees not treated as wages; meals served other employees treated as wages); and Rev. Rul. 62-150, 1962 Cum. Bull. 213 (meals generally treated as wages).

the current regulation fails to do. The decision of the court below is fully consistent with these principles.¹¹

Even if the regulation were to be given some particular weight, the court below was fully justified in finding that "as a guide to employers in their relations with employees, it is nearly worthless." (Pet. App. A. 14a.) As stated by this Court in *Central Illinois*, "[b]ecause the employer is in a secondary position as to liability for any tax of the employee, it is a matter of obvious concern that, absent further specific congressional action, the employer's obligation to withhold be precise and not speculative." 435 U.S. at 31. As the court below found, the regulation provides:

... As regards food and lodging furnished without charge, they are not "wages" unless they are "remuneration," and the regulation admits that not all food and lodging benefits are "remuneration." Only "ordinarily" and "generally" they are ... The employer who concludes subjectively that his free meals are not "remuneration," will not find anything in the regulation to tell him whether he is right or wrong on the particular facts of his case. ... The employer has no way of telling whether or not his plan is the ordinary or general

¹¹ The Government suggests (Pet. 16) that the Tropicana's awareness and apparent compliance with the Treasury's position prevents challenging the correctness of such position. In many instances, administrative positions on employment taxes will go unchallenged as the amount involved will not justify the tremendous costs of challenging such positions in court. The history and costs of this litigation as compared to the dollars in suit clearly bear this out. Rising employment tax rates and wage bases (from 1971, the year in suit, to 1979, the FICA wage base has risen from \$7,800 to \$22,900 and is projected to reach \$42,000 by 1986) are obviously changing the economics of challenging administrative positions. Prior acquiescence in a Treasury position due to economic necessity should have no bearing on the substantive merits of the position.

case, except language that seems to intimate the regulator is thinking of rather massive benefits. . . . The concluding part of the quoted regulation would tell him to compare the food or lodging benefits with the "total remuneration," but he is not told what ratio will trigger a classification one way or the other; *i.e.*, what part the regulator deems an "appreciable" part.¹² (Pet. App. A. 12a-13a.)

The uncertainty engendered by such language has been intensified by the fact that the Government has changed its published positions on the subjectibility of meals served for the convenience of employer to FICA and FUTA taxes no less than five times, notwithstanding the absence of any change whatever in the applicable statute or any change since 1940 in the applicable regulation.

The decision of the court below on the meal issue was correct and consistent with the statutory definition of "wages". Review of this issue by the Court is not warranted.

II. Reasons for Granting the Conditional Cross-Petition.

A. The decision of the court below on the claim for refund issue conflicts with prior and subsequent decisions of other courts.

The court below held that the Tropicana's claim for refund of the *employer* FICA tax paid with respect to the meals (based on the original \$.45 per meal valuation) was defective in that it did not specify what steps were being taken by the Tropicana to protect the *em-*

¹² The court below did not find it necessary to determine whether the value of the meals was \$.45 as contended by the Tropicana or \$1.25 as contended by the Government. At a value of \$.45, it has been stipulated that the meals constituted less than 3% of the amount of cash wages received by the employees involved and even at a \$1.25 rate only 8.3% of the total cash wages involved. (Stip. 22.)

ployee FICA tax.¹³ (Pet. App. A. 15a-17a.) The issue had been raised as an afterthought by the Government in its reply brief filed in the court below over three years after the instant suit had been filed in the Court of Claims, and almost six years after the Tropicana first advised the Internal Revenue Service in writing that the employee meals were not subject to FICA and FUTA taxes. In the court below, the Government asserted, citing as authority *Atlantic Department Stores, Inc. v. United States*, 557 F.2d 957 (C.A. 2d, 1977), that the Tropicana could not pursue its claim for refund of the employer portion of the FICA tax paid based on the \$.45 meal valuation without first either refunding to the affected employees their portion of the FICA tax withheld on the \$.45 meal valuation, or suing on their behalf for its recovery. While recognizing that *Atlantic Department Stores* concerned an "agreed error" situation with the Government admitting the FICA error, whereas the Government admits no error herein, the court below nonetheless held that there was an "equitable requirement" that the Tropicana must do "whatever was feasible to protect [the employees'] interests, short of actually distributing to them a still hypothetical refund" before it was entitled to bring suit to recover the employer FICA tax. (Pet. App. A. 17a.)

This holding of the court below conflicts with *Radio City Music Hall Corp. v. United States*, 50 F. Supp.

¹³ The Tropicana paid to the Internal Revenue Service with the filing of its quarterly employment tax returns for 1971 (1) the employer share of FICA tax and (2) the withheld employee share of FICA tax on the meals based on the \$.45 meal valuation. On audit the Service increased the valuation of the meals to \$1.25 per meal, and the Tropicana thereafter itself paid both the employer and employee shares of FICA tax on the \$.80 differential. (See Pet. App. A. 3a-4a.)

329 (S.D. N.Y., 1942), *aff'd*, 135 F.2d 715 (C.A. 2d, 1943). *Radio City* involved the classification of special artists as "employees" for FICA and FUTA tax purposes. Preliminarily, the Government had objected to the suit for refund brought by Radio City Music Hall on the grounds that:

... neither in its complaint nor in its moving affidavits does plaintiff show that its has repaid to the special artists mentioned any of the taxes deducted under Title XIII aforesaid, nor that it has secured the written consent of such employees to entitle it to a refund in an amount equal to the taxes which they contributed, as required by Treasury Regulation 91, Article 504, subdiv. 4. *Id.* at 330.¹⁴

The district court rejected this argument, stating:

... plaintiff, upon this motion, seeks to recover only the amount paid out of its own treasury and does not ask for the return of the \$405.84 contributed by the artists[,] *Id.*,

and granted the refund of employer taxes sought by Radio City Music Hall. 50 F. Supp. at 333.

Additionally, the holding below conflicts with *Palmer House Co. v. United States*, 44 A.F.T.R. 2d (P-H) ¶ 79-5290, 79-6002 (N.D. Ill., May 11, 1979), where, in denying the Government's motion to dismiss for lack of jurisdiction, the court held:

We find the *Atlantic* case distinguishable by the fact that it dealt with situations where there is an ascertainable payment error to which both parties

¹⁴ This part of Article 504, Reg. 91, is the predecessor to the current Reg. § 31.6402(a)-2(a)(2) which the Government erroneously claims (Gov't Opp. 5-6) to be applicable herein.

agree. In the instant situation, there is a genuine dispute as to whether the value of the meals provided is to be included in taxable wages.

We agree with the plaintiff in that the defendant's position would be acceptable only in situations where the Government concedes that the F.I.C.A. tax was improperly collected by it.

Even the court below—while coming to a different conclusion—acknowledged that “There is much to be said for this argument” (Pet. App. A. 16a-17a.)

The holding of the court below also conflicts in principle with *W.M. Webb, Inc. v. United States*, 271 F. Supp. 249 (E.D. La., 1967), *aff'd*, 402 F.2d 956 (C.A. 5th, 1968), *rev'd on other grounds*, 397 U.S. 179 (1970) and *Capital Trawlers, Inc., et al. v. United States*, 216 F. Supp. 440 (D. Me.), *aff'd per curiam*, 342 F.2d 506 (C.A. 1st, 1963). *See also Jones v. Goodson*, 121 F.2d 176 (C.A. 10th, 1971); *United States v. Plotkin*, 239 F. Supp. 129, 132 (E.D. Wis., 1965).

All of these cases recognize the right of an employer to bring suit for recovery of his share of FICA tax—*independent of and without regard to the withheld employee share*—in those situations where the Government is asserting that there is no error in FICA tax payments. This conflict should be resolved by this Court so that there will be a clear understanding as to what conditions must be met by an employer in order to bring suit on erroneous employment tax positions taken by the Government.

B. The decision of the court below on the claim for refund issue was incorrect and is of substantial importance.

Prior to the decision below, no case had ever held that where the proper applicability of FICA tax is in dispute (an “unagreed error” situation), an employer has any obligation with respect to his employees, or the FICA tax withheld from them, which constitutes a jurisdictional prerequisite to the employer bringing suit. *Atlantic Department Stores, Inc. v. United States*, *supra*, and its progeny, *Entenmann's Bakery, Inc. v. United States*, 465 F. Supp. 1118 (E.D. N.Y. 1979), (asserted by the Government to be applicable herein), involved the inclusion of “sick pay” in FICA wages which the Government admitted to be erroneous.¹⁵ The *Atlantic* court held that the interplay of Sections 6402 and 6413 of the Internal Revenue Code and the applicable regulations. (App. *infra*, 3a) placed on the employer the burden of first adjusting the FICA overpayment with its employees and then claiming a refund from the Internal Revenue Service for both employer and employee FICA shares. 557 F.2d at 960. The court stated that to do so was “reasonable” since “any overpayment of employee tax is likely to be the result of an error by the employer”. *Id.* at 961. Requiring an employer to refund to his employees their share of the FICA overpayment under such circumstances does not place the employer at risk. In contrast, where the Government asserts that no error has been made, as here, repayment places the employer at risk that a court will ultimately conclude that the Government was correct

¹⁵ “Sick pay” is specifically excluded from “wages” by Section 3121(a)(2)(B) of the Internal Revenue Code.

and that the repayment by the employer had been made improperly; it may then be too late for the employer to collect the tax from his employees a second time. The court below apparently perceived this risk, but nonetheless held that as a jurisdictional prerequisite to recovery, the Tropicana should have done "whatever was feasible to protect [its employees'] interests, short of actually distributing to them a still hypothetical refund." (Pet. App. A. 17a.)

The court below did not state what the employer could be expected to do to protect the employees' interests "short of actually distributing to them a still hypothetical refund." *Id.* The regulations applicable to admitted errors (Reg. §§ 31.6402(a)-2(a)(1) and 31.6413(a)-1(b)(1), App. *infra*, 5a-8a), upon which the Government seeks to rely here, state that an employer who has "ascertained" that FICA taxes have been overpaid must "(1) repay each employee the amount improperly withheld, (2) reimburse his employees by applying the amount of overcollected taxes against future FICA tax liability; or (3) secure the written consent of the employees to seek a credit or refund on their behalf." (Gov't Opp. 4.) But neither the Government nor the court below suggest what the employer can do short of making an actual reimbursement if, for example, he is for some reason unable to communicate with persons who may have left his employment, or otherwise unable to "secure their written consent . . . to seek a credit or refund on their behalf." *Id.*¹⁶

¹⁶ Contrary to the statement by the Government (Opp. 6, fn. 5) that the Tropicana did not comply with Reg. § 31.6402(a)-2(c) which requires a listing of the affected employees, in fact such a listing was attached to the Tropicana's formal claims for refund. See Stip. pars. 43-44, Stip. Exs. 14-17.

The impact of this aspect of the decision of the court below has been significant. In response to several of the current suits (see Pet. 9) involving the employee meal issue, the Government has filed a motion to dismiss based on the decision below.¹⁷ In at least one instance, a district court has declined to follow the decision of the Court of Claims below. *See, Palmer House Co. v. United States, supra.*

The impact of this decision is not limited to contested employee meal cases, but encompasses any question of FICA tax includability with respect to which an employer believes the Government to be in error. For example, the Government has cited to 1,331 cases pending administratively on fringe benefit questions (Pet. 9-10), all of which are potentially susceptible to being blocked by the Government from judicial re-

¹⁷ See, e.g., *Sparks Nugget, Inc. v. United States*, Ct. Cl. No. 290-79 T, where the Government filed on September 4, 1979, a motion to dismiss, asserting in pertinent part as follows:

Under Section 7422 of the Internal Revenue Code of 1954 (26 U.S.C.), no suit for refund may be maintained until a claim for refund, in accord with all statutory and regulatory provisions, has been filed with the Secretary. From the allegations in the petition and in the "claims for refund" incorporated therein (Pet. par. 7; Pet. Exs. A-H), it appears that taxpayer is claiming a refund solely for the employer's share of F.I.C.A. taxes under Section 3111 of the Internal Revenue Code of 1954 (26 U.S.C.). Taxpayer does not allege either in the "claims for refund" or in the petition that any efforts have been made to reimburse, locate, or inform *any* of the affected employees who, under taxpayer's theory of the case, have also overpaid their tax. Thus, taxpayer's "claims for refund" do not present the information necessary for an acceptable claim for refund. *Hotel Conquistador, Inc. v. United States*, No. 374-75 (Ct. Cl., April 18, 1979), 597 F.2d 1348. See also *Atlantic Department Stores, Inc. v. United States*, 557 F.2d 957 (C.A. 2, 1977). Therefore, this Court lacks jurisdiction over the subject matter of taxpayer's claim because taxpayer did not file valid claims for refund. § 7422, Internal Revenue Code of 1954 (26 U.S.C.).

view on their merits if the decision below stands. The only judicial recourse available to an employer in employment tax matters is to sue for a refund of taxes paid by him.¹⁸ The decision of the court below requiring an employer to do whatever is "feasible" to protect his employees' interests before filing such a suit could effectively prevent an employer from ever filing suit in the event the employees fail or refuse to consent to suit by the employer in their behalf. Review by this Court under these circumstances is accordingly warranted.

CONCLUSION

The petition for a writ of certiorari should be denied; the conditional cross-petition should be granted in the event the petition is granted.

Respectfully submitted,

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APPENDIX

¹⁸ Unlike an income tax deficiency, the employer may not petition the Tax Court and defer payment of FICA tax until the correctness of the Government's position is determined. *Cf. I.R.C. Sections 6211 and 6213.* Nor may he by statute bring an action for a declaratory judgment challenging the assessment, *cf. I.R.C. Sections 7428, 7476 and 7477*, nor expect to enjoin collection of the tax. *Cf. Enochs v. Williams Packing & Navigation Co., Inc.*, 370 U.S. 1 (1962).

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.) (1971):

SECTION 3101. RATE OF TAX.**(a) *Old-Age, Survivors, and Disability Insurance*—**

In addition to other taxes, there is hereby imposed on the income of every individual a tax equal to the following percentages of the wages (as defined in section 3121(a)) received by him with respect to employment (as defined in section 3121(b))—

* * *

(b) *Hospital Insurance*—In addition to the tax imposed by the preceding subsection, there is hereby imposed on the income of every individual a tax equal to the following percentages of the wages (as defined in section 3121(a)) received by him with respect to employment (as defined in section 3121(b))—

* * *

SECTION 3102. DEDUCTION OF TAX FROM WAGES.

(a) *Requirement*—The tax imposed by section 3101 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. . . .

* * *

SECTION 3111. RATE OF TAX.**(a) *Old-Age, Survivors, and Disability Insurance*—**

In addition to other taxes, there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 3121(a)) paid by him with respect to employment (as defined in section 3121(b))—

(b) *Hospital Insurance*—In addition to the tax imposed by the preceding subsection, there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 3121(a)) paid by him with respect to employment (as defined in section 3121(b))—

* * *

SECTION 3121. DEFINITIONS.

(a) *Wages*—For purposes of this chapter, the term “wages” means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; . . .

* * *

SECTION 3301. RATE OF TAX.

There is hereby imposed on every employer (as defined in section 3306(a)) for the calendar year 1970 and each calendar year thereafter an excise tax, with respect to having individuals in his employ, equal to 3.2 percent of the total wages (as defined in section 3306(b)) paid by him during the calendar year with respect to employment (as defined in section 3306(c)).

* * *

SECTION 3306. DEFINITIONS.

(b) *Wages*—For purposes of this chapter, the term “wages” means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; . . .

* * *

SECTION 3401. DEFINITIONS.

(a) *Wages*—For purposes of this chapter, the term “wages” means all remuneration (other than fees paid

to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash; . . .

* * *

SECTION 3402. INCOME TAX COLLECTED AT SOURCE.

(a) *Requirement of Withholding*—Every employer making payment of wages shall deduct and withhold upon such wages (except as otherwise provided in this section) a tax determined in accordance with the following tables. . . .

* * *

SECTION 6402. AUTHORITY TO MAKE CREDITS OR REFUNDS.

(a) *General Rule*—In the case of any overpayment, the Secretary or his delegate, within the applicable period of limitations, may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment and shall refund any balance to such person.

* * *

SECTION 6413. SPECIAL RULES APPLICABLE TO CERTAIN EMPLOYMENT TAXES.

(1) *General Rule*—If more than the correct amount of tax imposed by section 3101, 3111, 3201, 3221, or 3402 is paid with respect to any payment of remuneration, proper adjustments, with respect to both the tax and the amount to be deducted, shall be made, without interest, in such manner and at such times as the Secretary or his delegate may by regulations prescribe.

* * *

Treasury Regulations on Employment Tax (1954 Code)
(26 C.F.R.) (1971):

§ 31.3121(a)-1 *Wages*.

(f) Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as remuneration for employment if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees. The term "facilities or privileges", however, does not ordinarily include the value of meals or lodging furnished, for example, to restaurant or hotel employees, or to seamen or other employees aboard vessels, since generally these items constitute an appreciable part of the total remuneration of such employees.

* * *

§ 31.3306(b)-1 *Wages*.

(f) Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as remuneration for employment if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees. The term "facilities or privileges", however, does not ordinarily include the value of meals or lodging furnished, for example, to restaurant or hotel employees, or to seamen or other employees aboard vessels, since generally these items constitute an appreciable part of the total remuneration of such employees.

* * *

§ 31.3401(a)-1 *Wages*.

(b) *Certain specific items*—

* * *

(9) *Value of meals and lodging*—The value of any meals or lodging furnished to an employee by his employer is not subject to withholding if the value of the meals or lodging is excludable from the gross income of the employee. See § 1.119-1 of this chapter (Income Tax Regulations).

* * *

§ 31.6402(a)-2 *Credit or refund of tax under Federal Insurance Contributions Act or Railroad Retirement Tax Act*.

(a) *Claim by Person Who Paid Tax to District Director*—

(1) *In general*.—Any person who pays to the district director more than the correct amount of—

(i) Employee tax under section 3101, or employer tax under section 3111, of the Federal Insurance Contributions Act,

(ii) Employee tax under section 3201, employee representative tax under section 3211, or employer tax under section 3221, of the Railroad Retirement Tax Act,

(iii) Any such tax under a corresponding provision of prior law, or

(iv) interest, addition to the tax, additional amount, or penalty with respect to any such tax,

may file a claim for refund of the overpayment (except to the extent that the overpayment must be credited pursuant to § 31.3503-1 of Subpart F of the regulations in this part), or may claim credit for such overpayment, in the manner and subject to the condi-

tions stated in this section and § 31.6402-2 of this chapter (Regulations on Procedure and Administration). If credit is claimed pursuant to this section, the amount thereof shall be claimed by entering such amount as a deduction on a return filed by the person making the claim. The return on which the credit is claimed must be on a form which is prescribed for use, at the time of the claim, in reporting tax which corresponds to the tax overpaid. If credit is taken pursuant to this section, a claim on Form 843 is not required, but the return on which the credit is claimed shall have attached as a part thereof a statement which shall constitute the claim for credit, setting forth in detail the grounds and facts relied upon in support of the credit, designating the return period in which the error was ascertained, and setting forth such other information as may be required by the regulations in this subpart and by the instructions relating to the return. No refund or credit of employee tax under the Federal Insurance Contributions Act shall be allowed if for any reason (for example, an overcollection of employee tax having been inadvertently included by the employee in computing a special refund—see § 31.6413(c)-1) the employee has taken the amount of such tax into account in claiming a credit against, or refund of, his income tax, or if so, such claim has been rejected.

* * *

(c) *Statements to accompany employers' and employees' claims under the Federal Insurance Contributions Act*—Whenever a claim for credit or refund of employee tax under section 3101, employer tax under section 3111, or either such tax under a corresponding provision of prior law, is made with respect to remuneration which was erroneously reported on a return or schedule as wages paid to an employee, such claim shall include a statement showing (1) the identification number of the employer, if he was required to make

application therefor, (2) the name and account number of such employee, (3) the period covered by such return or schedule, (4) the amount of remuneration actually reported as wages for such employee, and (5) the amount of wages which should have been reported for such employee. No particular form is prescribed for making such statement, but if printed forms are desired, the district director will supply copies of Form 941c or Form 941c PR, whichever is appropriate, upon request.

* * *

§ 31.6413(a)-1 *Repayment by employer of tax erroneously collected from employee*

(b) After employer files return—

(1) Employee tax under the Federal Insurance Contributions Act of the Railroad Retirement Tax Act.

(i) If an employer collects from any employee and pays to the district director more than the correct amount of employee tax under section 3101 or section 3201, or a corresponding provision of prior law, and if the error has been ascertained within the applicable period of limitation on credit or refund, the employer shall repay or reimburse the employee in the amount thereof prior to the expiration of the return period following the return period in which the error is ascertained and prior to the expiration of such limitation period. This subparagraph has no application in any case in which an overcollection is made the subject of a claim by the employer for refund or credit, and the employer elects to secure the written consent of the employee to the allowance of the refund or credit under the procedure provided in paragraph (a)(2)(i) of § 31.6402(a)-2.

* * *

(iv) For purposes of this subparagraph, an error is ascertained when the employer has sufficient knowledge of the error to be able to correct it.

* * *

§ 31.6413(a)-2 *Adjustment of overpayment*

(2) Employer Tax. If an employer pays more than the correct amount of employer tax under section 3111 or section 3221, or a corresponding provision of prior law, the employer may claim credit for the amount of the overpayment in the manner, and subject to the conditions, stated in § 31.6402(a)-2. Such credit shall constitute an adjustment, without interest, if the amount thereof is entered on the same return on which the employer adjusts, pursuant to subparagraph (1) of this paragraph, a corresponding overpayment of employee tax.